

ST 99-33

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**"M. VALDIMAR" as responsible,
officer of "Nevermore Raven Corp.",**

Taxpayer

**No. 98-ST-0000
NPL # 0000**

**Kenneth J. Galvin
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Gust W. Dickett, on behalf of "M. Valdimar"; Mr. Alan Osheff on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to "M. Valdimar's" (hereinafter "Valdimar") protest of Notice of Penalty Liability No. #0000 (hereinafter the "NPL"). The NPL was issued by the Department against "Valdimar", as responsible officer of "Nevermore Raven Corporation", doing business as "Amantillado" Restaurant in "Someplace", Illinois. The NPL covered the period from July of 19xx through August of 19xx. A hearing was held in this matter on April 8, 1999, with "Valdimar" providing the only oral testimony. Following submission of all evidence and a review

of the record, it is recommended that the matter be resolved in favor of the Department. In support thereof, the following "Findings of Fact" and "Conclusions of Law" are made.

Findings of Fact:

1. The Department's prima facie case, inclusive of all jurisdictional elements, is established by the admission into evidence of NPL #0000, which shows a penalty for tax liability of "Nevermore Raven Corporation" in the amount of \$6,893.00, including interest calculated through November 14, 19xx. Dept. Gr. Ex. No. 1.
2. The NPL was issued against "Valdimar" on November 16, 19xx, and covers the period from July of 19xx through August of 19xx. Dept. Gr. Ex. No. 1.
3. On April 1, 19xx, "Valdimar" was notified by the Department of Revenue of an audit of "Nevermore Raven Corporation", d/b/a "Amantillado" Restaurant to be conducted May 20, 1992, for the period July 1, 19xx to August 12, 19xx. Tr. p. 11; Taxpayer's Ex. No.1.
4. As a result of the audit, the Department established a deficiency assessment for the taxable period for Retailers' Occupation Tax. The assessment was based on underreporting of receipts in the amount of \$35,470 and failure to include sales of \$17,500 in gross receipts. "Valdimar" had concluded that these sales of \$17,500 were made to exempt organizations. Tr. p. 12.
5. During the years 19xx and 19xx, "Valdimar" was the owner and the principal conducting business for "Amantillado" Restaurant and was 100% shareholder and president of "Nevermore Raven Corporation". Tr. p. 15.

6. During the period from June 5, 19xx to July 3, 19xx, "Valdimar" took out an equity loan on his home located at "1111 North Usher", in the amount of \$40,363.50, from "Associated Bank Group". Tr. pp. 17-19; Taxpayer's Ex. No. 3, p. 1.
7. As of December 5, 19xx, the home equity loan from "Associated Bank Group" had increased to \$129,864. Tr. p. 19; Taxpayer's Ex. No.3, p. 6.
8. As of August 6, 19xx, the home equity loan from "Associated Bank Group" had increased to \$180,000. Tr. p. 20; Taxpayer's Ex. No. 3, p. 13.
9. As of November 5, 19xx, the home equity loan from "Associated Bank Group" totaled \$255,000. Tr. p. 20-21; Taxpayer's Ex. No. 3, p. 16.
10. On November 20, 19xx, "Valdimar" served dinner to the "Sumerian" Veterans Organization. No sales tax was charged on this sale. Tr. p. 30-31; Taxpayer's Ex. No. 4, p. 2.
11. The "Sumerian" Veterans Organization began bringing in parties to the "Amantillado" Restaurant in 19xx. "Valdimar" did not charge sales tax to this group, because they had explained to him that they were a tax-exempt organization. Tr. p. 32.
12. On October 5, 19xx, "Valdimar" received a letter from the "Sumerian" War Veterans of the United States on their own stationary acknowledging that they had their annual dinner at "Amantillado" Restaurant on May 20, 19xx. Tr. p. 33, 40-41; Taxpayer's Ex. No. 5.
13. "Valdimar" received copies of letters written by the Illinois Department of Revenue and addressed to the (Catholic religious organization), (Jewish religious organization), (Institute of higher education I) and (Institute of higher education II), acknowledging

that these four organizations were exempt from retailers' occupation tax. Tr. pp. 35-36; Taxpayer's Ex. No. 6.

14. "Valdimar" did not charge sales tax on sales to these four organizations believing that they were exempt charities. Tr. p. 36.
15. "Nevermore Raven Corporation" was involuntarily dissolved on March 2, 19xx. Tr. p. 43; Taxpayer's Ex. No. 7.

Conclusions of Law:

The sole issue to be decided in this case is whether "Valdimar" should be held personally liable for the unpaid retailers' occupation tax of "Nevermore Raven Corporation". The statutory basis upon which any personal liability is premised is Section 13½ of the Retailers' Occupation Tax Act, which provides in relevant part:

Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment *** and who willfully fails to file such return or to make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon; The Department shall determine a penalty due under this Section according to its best judgment and information, and such determination shall be prima facie correct and shall be prima facie evidence of a penalty under this Section.
Ill. Rev. Stat., ch. 120, par. 452½ (1987).

It is clear under Section 13½ that personal liability will be imposed only upon a person who: (1) is "responsible" for filing corporate tax returns and/or making the tax payments; and (2) willfully fails to file and/or pay such taxes.¹

¹ Prior to January 1, 1994, Section 13½ of the Retailers' Occupation Tax Act governed the assessment of personal tax penalties against responsible corporate officers or employees. However

The admission into evidence of the NPL establishes the Department's *prima facie* case with regard to both the fact that "Valdimar" was a "responsible" officer and the fact that "Valdimar" "willfully" failed to file and or pay. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995). Once the Department has established a *prima facie* case, the burden shifts to the taxpayer to overcome the case. Masini v. Department of Revenue, 60 Ill.App.3d 11 (1st Dist. 1978).

At the hearing, "Valdimar" presented no evidence to suggest that he was not a "responsible" officer. In fact, during opening arguments, "Valdimar" counsel expressly conceded that:

And under the statute, the question – the issue is whether he is the officer. We agree that he was the officer, so that's not in issue ... That he was responsible for paying his taxes – and he did file sales tax returns in all of the 14 months that were involved here. Tr. p. 6.

Under these circumstances, I conclude that there is no doubt that "Valdimar" relationship with "Nevermore Raven Corporation" was such that he was responsible for filing "Nevermore Raven Corporation's" Retailers' Occupation Tax returns and making payment for those taxes. Thus, the only remaining question is whether "Valdimar" "willfully" failed to pay those taxes.

Section 13½ fails to define what constitutes a willful failure to file or pay taxes. Branson, *supra* at 254. Beginning in Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill. 2d 568 (1977), and concluding most recently in Branson, *supra*, the Illinois courts have attempted to clarify what constitutes a willful failure to pay or file taxes. In so doing the courts have, in general,

effective January 1, 1994, the penalty provision of Section 13½ was replaced by Section 3-7 of the Uniform Penalty and Interest Act (35 ILCS 735/3-7).

Here the taxes accrued in 1989 and 1990, while Section 13½ was in effect. On the other hand, the NPL was not issued until 1996. Thus, a question arises as to whether Section 13½ or Section 3-7 controls the case at hand. In Sweis v. Sweet, 269 Ill.App.3d 1, 12 (1995), it was held that the penalty provision "in effect at the time the tax was incurred" should be applied. In accordance with this holding, I conclude that Section 13½ is controlling.

adopted a broad interpretation of the words “willfully fails.” Department of Revenue ex rel. People v. Corrosion Systems, Inc., 185 Ill.App.3d 580 (4th Dist. 1989).

Under this broad interpretation, responsible officers are liable for: (1) intentional misconduct (see Branson, *supra* at 259 (“if a responsible officer uses collected retailers’ occupation taxes to pay other creditors of the corporation, while knowing that he or she was obligated to file the returns and remit the taxes, the willful element of Section 13½ is satisfied”)); (2) reckless acts (*e.g.*, Bublick, *supra*, (responsible officer liable where he arbitrarily informed bookkeeper to report only 50% of the gross receipts on the grounds that 50% of the corporations sales were for resale, rather than following the proper method, which was to report all sales and then subtract actual sales for resale)); and (3) negligent acts (Branson, *supra* at 267 (noting that responsible officers would be liable if they delegate bookkeeping duties to third parties and fail to inspect corporate records or otherwise fail to keep informed of the status of the retailers’ occupation tax returns and payments)).

"Valdimar" contends that the proceeds of the home equity loan went into his restaurant business under the account of "Amantillado" Restaurant. Tr. p. 19. According to "Valdimar", he borrowed \$255,000 from a home equity loan over the course of several months and all of this money was loaned to the business and none of it was ever returned to him. Tr. pp. 20-21. At the time that "Nevermore Raven Corporation" was audited, "Valdimar" only had 10 of 14 bank statements. According to "Valdimar", the auditor taxed \$35,474 as unreported receipts, as a result of the missing bank statements. "Valdimar" argues that the “unreported receipts” were actually deposits of the home equity loan into the restaurant’s bank account. Tr. pp. 17-22.

"Valdimar" had admitted as evidence, copies of "Associated Bank Group’s" bank statements from July 3, 19xx through November 5, 19xx, which encompasses the period of the audit, July of 19xx through August of 19xx. These bank statements cover each month in the period

and show the home equity loan beginning at \$40,000 and eventually increasing to \$255,000. The names on the account are "M. Valdimar" and "B. Valdimar".

Although the bank statements show that "Valdimar" took out a home equity loan during the period of the audit, no evidence was admitted by "Valdimar" which would show where the home equity loan was deposited. "Valdimar" testified that the proceeds of the loan were deposited under the account of "Amantillado" Restaurant but no bank statement of "Amantillado" Restaurant was admitted as evidence. A taxpayer cannot overcome the Department's prima facie case merely by denying the accuracy of its assessments. Instead, evidence must be presented which is consistent, probable and identified with its book and records. Central Furniture Mart, Inc. v. Johnson, 157 Ill.App.3d 907 (1987). No documentary evidence was presented to show that any proceeds of the home equity loan were deposited in "Amantillado" Restaurant's bank account or used by the business.

"Valdimar" testified further that at the time of the audit, he only had ten of fourteen bank statements and the auditor taxed approximately \$35,000 as unreported receipts, as a result of the missing bank statements. According to "Valdimar", the unreported receipts were actually deposits of the home equity loan into the restaurant's bank account. At the hearing on April 8, 1999, no evidence was presented as to which four months of bank statements were missing. No evidence was presented as to the dollar amount of the home equity loan during these four months and how this dollar amount relates to the approximately \$35,000 in unreported receipts found by the auditor.

The evidence presented at trial proves that "Valdimar" took out a home equity loan during the period of the audit. "Valdimar" has failed to prove that the home equity loan was deposited in the bank account of "Amantillado" Restaurant or used by the business. In addition, "Valdimar" has failed to connect the four months of missing bank statements and the home equity loan

borrowed during these four months to the \$35,000 in unreported receipts found by the auditor. In accordance with Central Furniture Mart, Inc., *supra*, "Valdimar"' testimony on these issues is not sufficient, by itself, to overcome the Department's *prima facie* case. Because of the lack of documentary evidence on these issues, I conclude that "Valdimar" has failed to rebut the Department's *prima facie* case.

"Valdimar" next contends that the auditor disallowed certain sales to exempt organizations because "Valdimar" was not able to produce exemption letters at the time of the audit. Tr. pp. 6-8. "Valdimar" testified that the auditor disallowed a sale to the "Sumerian" Veterans Organization on August 15, 19xx. According to "Valdimar", this sale was claimed as a deduction on the sales tax return for 19xx. Tr. pp. 30-31. "Valdimar" believed that the "Sumerian" Veterans Organization was exempt. Tr. p. 31. He stated that the organization had been bringing parties to the restaurant since 19xx, and that during that time "tax was deducted by them presenting to me forms explaining to me that they were a tax deductible organization." Tr. p. 32. Additionally, "Valdimar" received exemption letters from the (Catholic religious organization), (Jewish religious organization), (Institute of higher education I) and (Institute of higher education II). These letters were written by the Department of Revenue. "Valdimar" did not charge tax to these organizations, believing that they were "exempt charities." Tr. p. 36.

Based upon the documents he presented at hearing, I find that "Valdimar"' actions were not reckless, as in Bublick, *supra*, as he did not arbitrarily under-report sales to the exempt organizations. Similarly, there was no issue of "Valdimar" delegating authority to a bookkeeper or accountant here, as in Branson, *supra*, and, accordingly, I find that there was no negligence on "Valdimar"' part which would satisfy the requirement of "willfulness."

I have concluded that "Valdimar" believed that certain organizations were exempt from sales tax based upon documents he received from them. "Valdimar" apparently did not have a letter exempting the "Sumerian" Veterans Organization. However, he had sold to them since 19xx and they had explained to him that they were an exempt organization. Tr. p. 32. "Valdimar" had copies of exemption letters for four other organizations. Although the letters were not current, "Valdimar" did not charge sales tax to these organizations. The Retailers' Occupation Tax Act requires that any person selling to an exempt purchaser keep records "as may be necessary to establish the non-taxable character of the transaction" in order to support the deduction on the tax return. 35 ILCS 120/7. "Valdimar" kept letters to support the deductions in compliance with the statute, although the letters were not current. "Valdimar" has presented adequate documentary evidence to establish the basis of his belief that the organizations were exempt from sales tax and I have concluded that there was no willful failure to pay on "Valdimar" part based upon the documents he received from these organizations.

However, "Valdimar" has presented no documentary evidence which relates the sales to these exempt organizations to the \$17,500 in exempt sales disallowed by the auditor. The only exempt sale documented by "Valdimar" in his "Banquet Red Book" is a sale for \$476 or \$477 to the "Sumerian" Veteran's Organization. Tr. p. 29. Taxpayer's Ex. No. 4. "Valdimar" has not presented any evidence that the auditor disallowed this sale and, accordingly, I cannot credit the NPL. In addition, "Valdimar" failed to produce at the hearing books and records which would show the dollar amount of the sales to the other four exempt organizations or that the auditor disallowed the sales. Accordingly, whereas I have concluded that there was no willful failure to pay certain taxes on "Valdimar" part, the evidence presented is legally insufficient to sustain "Valdimar" burden of rebutting the prima facie correctness of the Department's assessment of

disallowed sales of \$17,500. A.R. Barnes & Co. v. Dept. of Revenue, 173 Ill.App.3d 826 (1st Dist. 1988)

WHEREFORE, for the reasons stated above, it is my recommendation that the Notice of Penalty Liability be finalized as issued.

June 25, 1999

Kenneth J. Galvin
Administrative Law Judge